PORTFOLIO RECOVERY ASSOCIATES INC
Form 10-Q
November 06, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2009

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _________ to _________

Commission File Number: 000-50058

Portfolio Recovery Associates, Inc.

(Exact name of registrant as specified in its charter)

Delaware	75-3078675
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
120 Corporate Boulevard, Norfolk, Virginia	23502
(Address of principal executive offices)	*(zip code)*

(888) 772-7326

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES þ NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o
(Do not check if a smaller reporting company)

YES o NO o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES o NO þ

The number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class

	Outstanding as of October 19, 2009
Common Stock, $0.01 par value	15,491,725

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PORTFOLIO RECOVERY ASSOCIATES, INC.
CONSOLIDATED BALANCE SHEETS
September 30, 2009 and December 31, 2008
(unaudited)
(Amounts in thousands, except per share amounts)

	September 30, 2009	December 31, 2008
Assets		
Cash and cash equivalents	$ 19,874	$ 13,901
Finance receivables, net	660,879	563,830
Accounts receivable, net	6,909	8,278
Income taxes receivable	5,893	3,587
Property and equipment, net	22,093	23,884
Goodwill	29,299	27,546
Intangible assets, net	11,425	13,429
Other assets	3,310	3,385
Total assets	$ 759,682	$ 657,840
Liabilities and Stockholders Equity		
Liabilities:		
Accounts payable	$ 3,957	$ 3,438
Accrued expenses	3,463	4,314
Accrued payroll and bonuses	11,294	9,850
Deferred tax liability	110,333	88,070
Line of credit	306,300	268,300
Long-term debt	1,663	
Obligations under capital lease		5
Derivative instrument	566	
Total liabilities	437,576	373,977
Commitments and contingencies (Note 12)		
Stockholders equity:		
Preferred stock, par value $0.01, authorized shares, 2,000, issued and outstanding shares 0		
Common stock, par value $0.01, authorized shares, 30,000, 15,573 issued and 15,491 outstanding shares at September 30, 2009, and 15,398 issued and 15,286 outstanding shares at December 31, 2008	155	153
Additional paid-in capital	81,358	74,574
Retained earnings	240,939	209,047
Accumulated other comprehensive (loss)/income, net of tax	(346)	89

Total stockholders equity		322,106		283,863
Total liabilities and stockholders equity	$	759,682	$	657,840

The accompanying notes are an integral part of these consolidated financial statements.

PORTFOLIO RECOVERY ASSOCIATES, INC.
CONSOLIDATED INCOME STATEMENTS
For the three and nine months ended September 30, 2009 and 2008
(unaudited)
(Amounts in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Revenues:				
Income recognized on finance receivables, net	$ 54,336	$ 52,738	$ 159,650	$ 158,412
Commissions	14,229	15,831	48,225	37,874
Total revenues	68,565	68,569	207,875	196,286
Operating expenses:				
Compensation and employee services	26,844	22,983	79,940	64,983
Legal and agency fees and costs	11,296	14,386	34,460	39,530
Outside fees and services	2,284	2,323	6,854	6,870
Communications	3,472	2,263	11,157	7,535
Rent and occupancy	1,270	1,123	3,515	2,830
Other operating expenses	2,341	1,912	6,565	4,863
Depreciation and amortization	2,269	2,162	6,874	5,138
Total operating expenses	49,776	47,152	149,365	131,749
Income from operations	18,789	21,417	58,510	64,537
Other income and (expense):				
Interest income		34	3	67
Interest expense	(1,964)	(3,066)	(5,891)	(8,215)
Income before income taxes	16,825	18,385	52,622	56,389
Provision for income taxes	6,729	6,930	20,730	21,638
Net income	$ 10,096	$ 11,455	$ 31,892	$ 34,751
Net income per common share:				
Basic	$ 0.65	$ 0.75	$ 2.07	$ 2.28
Diluted	$ 0.65	$ 0.75	$ 2.07	$ 2.27
Weighted average number of shares outstanding:				
Basic	15,466	15,267	15,392	15,210

Diluted	15,502	15,336	15,428	15,280

The accompanying notes are an integral part of these consolidated financial statements.

PORTFOLIO RECOVERY ASSOCIATES, INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME
For the nine months ended September 30, 2009
(unaudited)
(Amounts in thousands)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)/Income	Total Stockholders Equity
Balance at December 31, 2008	$ 153	$ 74,574	$ 209,047	$ 89	$ 283,863
Net income			31,892		31,892
Net unrealized change in:					
Interest rate swap derivative, net of tax				(435)	(435)
Comprehensive income					31,457
Exercise of stock options and vesting of nonvested shares	2	1,628			1,630
Issuance of common stock for acquisition		1,170			1,170
Amortization of share-based compensation		3,240			3,240
Income tax benefit from share-based compensation		746			746
Balance at September 30, 2009	$ 155	$ 81,358	$ 240,939	$ (346)	$ 322,106

The accompanying notes are an integral part of these consolidated financial statements.

PORTFOLIO RECOVERY ASSOCIATES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the nine months ended September 30, 2009 and 2008
(unaudited)
(Amounts in thousands)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Cash flows from operating activities:		
Net income	$ 31,892	$ 34,751
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of share-based compensation	3,240	442
Depreciation and amortization	6,874	5,138
Deferred tax expense	22,000	23,771
Changes in operating assets and liabilities:		
Other assets	(14)	182
Accounts receivable	1,369	(77)
Accounts payable	520	(77)
Income taxes	(2,306)	(513)
Accrued expenses	(851)	567
Accrued payroll and bonuses	1,443	1,875
Net cash provided by operating activities	64,167	66,059
Cash flows from investing activities:		
Purchases of property and equipment	(3,079)	(4,041)
Acquisition of finance receivables, net of buybacks	(210,116)	(214,172)
Collections applied to principal on finance receivables	113,067	89,039
Company acquisitions, including acquisition costs and net of cash acquired	(100)	(25,791)
Net cash used in investing activities	(100,228)	(154,965)
Cash flows from financing activities:		
Proceeds from exercise of options	1,630	594
Income tax benefit from share-based compensation	746	368
Proceeds from line of credit	84,500	146,300
Principal payments on line of credit	(46,500)	(47,000)
Proceeds from long-term debt	2,036	
Principal payments on long-term debt	(373)	
Principal payments on capital lease obligations	(5)	(80)
Net cash provided by financing activities	42,034	100,182
Net increase in cash and cash equivalents	5,973	11,276

Cash and cash equivalents, beginning of period		13,901		16,730
Cash and cash equivalents, end of period	$	19,874	$	28,006
Supplemental disclosure of cash flow information:				
Cash paid for interest	$	6,028	$	8,272
Cash paid for income taxes	$	321	$	3
Noncash investing and financing activities:				
Common stock issued for acquisition	$	1,170	$	1,847
Net unrealized change in fair value of derivative instrument	$	(655)	$	

The accompanying notes are an integral part of these consolidated financial statements.

PORTFOLIO RECOVERY ASSOCIATES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Organization and Business:

Portfolio Recovery Associates, LLC (PRA) was formed on March 20, 1996. Portfolio Recovery Associates, Inc. (PRA Inc) was formed in August 2002. On November 8, 2002, PRA Inc completed its initial public offering (IPO) of common stock. As a result, all of the membership units and warrants of PRA were exchanged on a one to one basis for warrants and shares of a single class of common stock of PRA Inc. PRA Inc owns all outstanding membership units of PRA, PRA Holding I, LLC (PRA Holding I), PRA Holding II, LLC (PRA Holding II), PRA Receivables Management, LLC (formerly d/b/a Anchor Receivables Management) (Anchor), PRA Location Services, LLC (d/b/a IGS Nevada) (IGS), PRA Government Services, LLC (d/b/a RDS) (RDS) and MuniServices, LLC (MuniServices). PRA Inc, a Delaware corporation, and its subsidiaries (collectively, the Company) are full-service providers of outsourced receivables management and related services. The Company is engaged in the business of purchasing, managing and collecting portfolios of defaulted consumer receivables, as well as offering a broad range of accounts receivable management services. The majority of the Company s business activities involve the purchase, management and collection of defaulted consumer receivables. These are purchased from sellers of finance receivables and collected by a highly skilled staff whose purpose is to locate and contact customers and arrange payment or resolution of their debts. The Company, through its Litigation Department, collects accounts judicially, either by using its own attorneys, or by contracting with independent attorneys throughout the country through whom the Company takes legal action to satisfy consumer debts. The Company also services receivables on behalf of clients on either a commission or transaction-fee basis. Clients include entities in the financial services, auto, retail, utility, health care and government sectors. Services provided to these clients include standard collection services on delinquent accounts, obtaining location information for clients in support of their collection activities (known as skip tracing), and the management of both delinquent and non-delinquent receivables for government entities.

The consolidated financial statements of the Company include the accounts of PRA Inc, PRA, PRA Holding I, PRA Holding II, Anchor, IGS, RDS and MuniServices. Under the guidance of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 280 Segment Reporting (ASC 280), the Company determined that it has several operating segments that meet the aggregation criteria of ASC 280, and therefore, it has one reportable segment, accounts receivable management, based on similarities among the operating units including homogeneity of services, service delivery methods and use of technology.

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission (SEC) and, therefore, do not include all information and disclosures required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of the Company, however, the accompanying unaudited consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the Company s consolidated balance sheet as of September 30, 2009, its consolidated income statements for the three and nine months ended September 30, 2009 and 2008, its consolidated statement of changes in stockholders equity and comprehensive income for the nine months ended September 30, 2009, and its consolidated statements of cash flows for the nine months ended September 30, 2009 and 2008. The consolidated income statements of the Company for the three and nine months ended September 30, 2009 may not be indicative of future results. Certain reclassifications have been made to prior year amounts to conform to the current year presentation. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K, as filed for the year ended December 31, 2008.

2. Finance Receivables, net:

The Company s principal business consists of the acquisition and collection of pools of accounts that have experienced deterioration of credit quality between origination and the Company s acquisition of the accounts. The amount paid for any pool reflects the Company s determination that it is probable the Company will be unable to collect all amounts due according to an account s contractual terms. At acquisition, the Company reviews the portfolio both by account and aggregate pool to determine whether there is evidence of deterioration of credit quality

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PORTFOLIO RECOVERY ASSOCIATES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

since origination and if it is probable that the Company will be unable to collect all amounts due according to the account s contractual terms. If both conditions exist, the Company determines whether each such account is to be accounted for individually or whether such accounts will be assembled into pools based on common risk characteristics. The Company considers expected prepayments and estimates the amount and timing of undiscounted expected principal, interest and other cash flows for each acquired portfolio and subsequently aggregates pools of accounts. The Company determines the excess of the pool s scheduled contractual principal and contractual interest payments over all cash flows expected at acquisition as an amount that should not be accreted (nonaccretable difference) based on the Company s proprietary acquisition models. The remaining amount, representing the excess of the pool s cash flows expected to be collected over the amount paid, is accreted into income recognized on finance receivables over the remaining life of the pool (accretable yield).

The Company accounts for its investment in finance receivables under the guidance of FASB ASC Topic 310-30 Loans and Debt Securities Acquired with Deteriorated Credit Quality (ASC 310-30). Under ASC 310-30, static pools of accounts may be established. These pools are aggregated based on certain common risk criteria. Each static pool is recorded at cost, which includes certain direct costs of acquisition paid to third parties, and is accounted for as a single unit for the recognition of income, principal payments and loss provision. Once a static pool is established for a quarter, individual receivable accounts are not added to the pool (unless replaced by the seller) or removed from the pool (unless sold or returned to the seller). ASC 310-30 requires that the excess of the contractual cash flows over expected cash flows not be recognized as an adjustment of revenue or expense or on the balance sheet. ASC 310-30 initially freezes the internal rate of return, referred to as IRR, estimated when the accounts receivable are purchased as the basis for subsequent impairment testing. Significant increases in actual, or expected future cash flows may be recognized prospectively through an upward adjustment of the IRR over a portfolio s remaining life. Any increase to the IRR then becomes the new benchmark for impairment testing. Effective for fiscal years beginning after December 15, 2004 under ASC 310-30, rather than lowering the estimated IRR if the collection estimates are not received or projected to be received (as was permitted under the prior accounting guidance), the carrying value of a pool would be written down to maintain the then current IRR and is shown as a reduction in revenue in the consolidated income statements with a corresponding valuation allowance offsetting finance receivables, net, on the consolidated balance sheet. Income on finance receivables is accrued quarterly based on each static pool s effective IRR. Quarterly cash flows greater than the interest accrual will reduce the carrying value of the static pool. This reduction in carrying value is defined as payments applied to principal (also referred to as finance receivable amortization). Likewise, cash flows that are less than the interest accrual will accrete the carrying balance. The Company generally does not allow accretion in the first six to twelve months; accordingly, the Company utilizes either the cost recovery method or cash method when necessary to prevent accretion as permitted by ASC 310-30. The IRR is estimated and periodically recalculated based on the timing and amount of anticipated cash flows using the Company s proprietary collection models. A pool can become fully amortized (zero carrying balance on the balance sheet) while still generating cash collections. In this case, all cash collections are recognized as revenue when received. Under the cash method, revenue is recognized as it would be under the interest method up to the amount of cash collections. Additionally, the Company uses the cost recovery method when collections on a particular pool of accounts cannot be reasonably predicted. These pools are not aggregated with other portfolios. Under the cost recovery method, no revenue is recognized until the Company has fully collected the cost of the portfolio, or until such time that the Company considers the collections to be probable and estimable and begins to recognize income based on the interest method as described above. At September 30, 2009 and 2008, the Company had unamortized purchased principal (purchase price) in pools accounted for under the cost recovery method of $3,619,322 and $3,546,509, respectively.

The Company establishes valuation allowances for all acquired accounts subject to ASC 310-30 to reflect only those losses incurred after acquisition (that is, the present value of cash flows initially expected at acquisition that are no longer expected to be collected). Valuation allowances are established only subsequent to acquisition of the accounts. At September 30, 2009 and 2008, the Company had an allowance against its finance receivables of $41,770,000 and $14,755,000, respectively. Prior to January 1, 2005, in the event that a reduction of the yield to as low as zero in conjunction with estimated future cash collections that were inadequate to amortize the carrying balance, an allowance charge would be taken with a corresponding write-off of the receivable balance.

PORTFOLIO RECOVERY ASSOCIATES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

The Company implements the accounting for income recognized on finance receivables under ASC 310-30 as follows. The Company creates each accounting pool using its projections of estimated cash flows and expected economic life. The Company then computes the effective yield that fully amortizes the pool to the end of its expected economic life based on the current projections of estimated cash flows. As actual cash flow results are recorded, the Company balances those results to the data contained in its proprietary models to ensure accuracy, then reviews each accounting pool watching for trends, actual performance versus projections and curve shape, sometimes re-forecasting future cash flows utilizing the Company s statistical models. The review process is primarily performed by the Company s finance staff; however, the Company s operational and statistical staffs may also be involved depending upon actual cash flow results achieved. To the extent there is overperformance, the Company will either increase the yield or release the allowance, if persuasive evidence indicates that the overperformance is considered to be a significant betterment, or, if the overperformance is considered more of an acceleration of cash flows (a timing difference), adjust future cash flows downward which effectively extends the amortization period, or take no action at all if the amortization period is reasonable and falls within the pools expected economic life. To the extent there is underperformance, the Company will book an allowance if the underperformance is significant and will also consider revising future cash flows based on current period information, or take no action if the pool s amortization period is reasonable and falls within the currently projected economic life.

The Company capitalizes certain fees paid to third parties related to the direct acquisition of a portfolio of accounts. These fees are added to the acquisition cost of the portfolio and accordingly are amortized over the life of the portfolio using the interest method. The balance of the unamortized capitalized fees at September 30, 2009 and 2008 was $3,262,929 and $3,013,671, respectively. During the three and nine months ended September 30, 2009, the Company capitalized $156,248 and $805,962, respectively, of these direct acquisition fees. During the three and nine months ended September 30, 2008, the Company capitalized $198,257 and $1,065,786, respectively, of these direct acquisition fees. During the three and nine months ended September 30, 2009, the Company amortized $206,270 and $621,593, respectively, of these direct acquisition fees. During the three and nine months ended September 30, 2008, the Company amortized $153,391 and $487,031, respectively, of these direct acquisition fees.

The agreements to purchase the aforementioned receivables include general representations and warranties from the sellers covering account holder death or bankruptcy and accounts settled or disputed prior to sale. The representation and warranty period permitting the return of these accounts from the Company to the seller is typically 90 to 180 days. Any funds received from the seller of finance receivables as a return of purchase price are referred to as buybacks. Buyback funds are simply applied against the finance receivable balance received and are not included in the Company s cash collections from operations. In some cases, the seller will replace the returned accounts with new accounts in lieu of returning the purchase price. In that case, the old account is removed from the pool and the new account is added.

Changes in finance receivables, net for the three and nine months ended September 30, 2009 and 2008 are as follows (amounts in thousands):

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Balance at beginning of period	$ 624,592	$ 515,367	$ 563,830	$ 410,297
Acquisitions of finance receivables, net of buybacks	74,318	50,333	210,116	214,172
Cash collections	(92,367)	(83,008)	(272,717)	(247,451)
	54,336	52,738	159,650	158,412

Income recognized on finance receivables, net								
Cash collections applied to principal		(38,031)		(30,270)		(113,067)		(89,039)
Balance at end of period	$	660,879	$	535,430	$	660,879	$	535,430

PORTFOLIO RECOVERY ASSOCIATES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

At the time of acquisition, the life of each pool is generally estimated to be between 84 to 96 months based on projected amounts and timing of future cash receipts using the proprietary models of the Company. As of September 30, 2009, the Company had $660,879,132 in net finance receivables. Based upon current projections, cash collections applied to principal are estimated to be as follows for the twelve months in the periods ending (amounts in thousands):

September 30, 2010	$ 136,625
September 30, 2011	162,067
September 30, 2012	161,128
September 30, 2013	122,993
September 30, 2014	51,970
September 30, 2015	21,598
September 30, 2016	4,028
September 30, 2017	470
	$ 660,879

During the three and nine months ended September 30, 2009, the Company purchased approximately $1.75 billion and $6.09 billion, respectively, in face value of charged-off consumer receivables. During the three and nine months ended September 30, 2008, the Company purchased approximately $857.2 million and $3.28 billion, respectively, in face value of charged-off consumer receivables. At September 30, 2009, the estimated remaining collections (ERC) on the receivables purchased in the three months ended September 30, 2009 and 2008 were $165.3 million and $82.6 million, respectively. At September 30, 2009, the estimated remaining collections (ERC) on the receivables purchased in the nine months ended September 30, 2009 and 2008 were $453.8 million and $294.4 million, respectively.

Accretable yield represents the amount of income recognized on finance receivables the Company can expect to generate over the remaining life of its existing portfolios based on estimated future cash flows as of September 30, 2009 and 2008. Reclassifications from nonaccretable difference to accretable yield primarily result from the Company s increase in its estimate of future cash flows. Reclassifications to nonaccretable difference from accretable yield results from the Company s decrease in its estimates of future cash flows and allowance charges that exceed the Company s increase in its estimate of future cash flows. Changes in accretable yield for the three and nine months ended September 30, 2009 and 2008 were as follows (amounts in thousands):

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Balance at beginning of period	$ 613,392	$ 549,716	$ 551,735	$ 492,269
Income recognized on finance receivables, net	(54,336)	(52,738)	(159,650)	(158,412)
Additions	106,359	57,184	303,195	220,573
Reclassifications (to)/from nonaccretable difference	5,618	(4,592)	(24,247)	(4,860)
Balance at end of period	$ 671,033	$ 549,570	$ 671,033	$ 549,570

The Company recorded allowance charges on pools that had underperformed the Company s most recent expectations during the three and nine months ended September 30, 2009 and 2008 as follows:

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Balance at beginning of period	$ 33,760	$ 10,975	$ 23,620	$ 4,230
Allowance charges recorded	8,395	3,985	19,305	10,870
Reversal of previously recorded allowance charges	(385)	(205)	(1,155)	(345)
Change in allowance charge	8,010	3,780	18,150	10,525
Balance at end of period	$ 41,770	$ 14,755	$ 41,770	$ 14,755

PORTFOLIO RECOVERY ASSOCIATES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

3. Accounts Receivable, net:

Accounts receivable are recorded at the invoiced amount and do not bear interest. Amounts collected on accounts receivable are included in net cash provided by operating activities in the consolidated statements of cash flows. The Company maintains an allowance for doubtful accounts for estimated losses inherent in its accounts receivable portfolio. In establishing the required allowance, management considers historical losses adjusted to take into account current market conditions and its customers financial condition, the amount of receivables in dispute, and the current receivables aging and current payment patterns. The Company reviews its allowance for doubtful accounts monthly. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The balance of the allowance for doubtful accounts at September 30, 2009 and December 31, 2008 was $2.7 million and $2.0 million, respectively. The Company does not have any off balance sheet credit exposure related to its customers.

4. Line of Credit:

On November 29, 2005, the Company entered into a Loan and Security Agreement for a revolving line of credit. The agreement has been amended six times to add additional lenders and ultimately increase the total availability of credit under the line to $365 million. The agreement is a line of credit in an amount equal to the lesser of $365 million or 30% of the Company s ERC of all its eligible asset pools. Borrowings under the revolving credit facility bear interest at a floating rate equal to the one month LIBOR Market Index Rate plus 1.40%, which was 1.65% at September 30, 2009, and the facility expires on May 2, 2011. The Company also pays an unused line fee equal to three-tenths of one percent, or 30 basis points, on any unused portion of the line of credit. The loan is collateralized by substantially all the tangible and intangible assets of the Company. The agreement provides as follows:

- monthly borrowings may not exceed 30% of ERC;
- funded debt to EBITDA (defined as net income, less income or plus loss from discontinued operations and extraordinary items, plus income taxes, plus interest expense, plus depreciation, depletion, amortization (including finance receivable amortization) and other non-cash charges) ratio must be less than 2.0 to 1.0 calculated on a rolling twelve-month average;
- tangible net worth must be at least 100% of tangible net worth reported at September 30, 2005, plus 25% of cumulative positive net income since the end of such fiscal quarter, plus 100% of the net proceeds from any equity offering without giving effect to reductions in tangible net worth due to repurchases of up to $100,000,000 of the Company s common stock; and
- restrictions on change of control.

As of September 30, 2009 and 2008, outstanding borrowings under the facility totaled $306,300,000 and $267,300,000, respectively, of which $50,000,000 was part of the non-revolving fixed rate sub-limit which bears interest at 6.80% and expires on May 4, 2012. As of September 30, 2009, the Company is in compliance with all of the covenants of the agreement.

5. Derivative Instruments:

The Company may periodically enter into derivative financial instruments, typically interest rate swap agreements, to reduce its exposure to fluctuations in interest rates on variable-rate debt and their impact on earnings and cash flows. The Company does not utilize derivative financial instruments with a level of complexity or with a risk greater than the exposure to be managed nor does it enter into or hold derivatives for trading or speculative purposes. The Company periodically reviews the creditworthiness of the swap counterparty to assess the counterparty s ability to honor its obligation. Counterparty default would expose the Company to fluctuations in variable interest rates. Based on the guidance of FASB ASC Topic 815 Derivatives and Hedging (ASC 815), the Company records derivative financial instruments at fair value.

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PORTFOLIO RECOVERY ASSOCIATES, INC.
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(unaudited)

On December 16, 2008, the Company entered into an interest rate forward rate swap transaction (the Swap) with J.P. Morgan Chase Bank, National Association pursuant to an ISDA Master Agreement which contains customary representations, warranties and covenants. The Swap has an effective date of January 1, 2010, with an initial notional amount of $50,000,000. Under the Swap, the Company will receive a floating interest rate based on 1-month LIBOR Market Index Rate and will pay a fixed interest rate of 1.89% through maturity of the Swap on May 1, 2011. Notwithstanding the terms of the Swap, the Company is ultimately obligated for all amounts due and payable under the credit facility.

The Company s financial derivative instrument is designated and qualifies as a cash flow hedge, and the effective portion of the gain or loss on such hedge is reported as a component of other comprehensive income in the consolidated financial statements. To the extent that the hedging relationship is not effective, the ineffective portion of the change in fair value of the derivative is recorded in other income (expense). The hedge was considered effective for the period from December 16, 2008 through December 31, 2008 and for the three and nine months ended September 30, 2009. Therefore, no amount has been recorded in the consolidated income statements related to the hedge s ineffectiveness during 2008 or the three and nine months ended September 30, 2009. Hedges that receive designated hedge accounting treatment are evaluated for effectiveness at the time that they are designated, as well as throughout the hedging period.

The following table sets forth the fair value amounts of derivative instruments held by the Company as of the dates indicated (amounts in thousands):

	September 30, 2009		**December 31, 2008**	
	Asset Derivatives	Liability Derivatives	Asset Derivatives	Liability Derivatives
Derivatives designated as hedging instruments under ASC 815:				
Interest rate swap contracts	$	$ 566	$ 89	$
Total derivatives	$	$ 566	$ 89	$

Liability and asset derivatives are recorded in the liability and other asset section of the accompanying consolidated balance sheets, respectively.

The following table sets forth the gain (loss) recorded in Accumulated Other Comprehensive Income (AOCI), net of tax, for the three and nine months ended September 30, 2009, for derivatives held by the Company as well as any gain (loss) reclassified from AOCI into income (amounts in thousands):

	For the three months ended September 30, 2009		
	Amount of Gain or (Loss) Recognized in Other Comprehensive Income on Derivatives	Location of Gain or (Loss) Reclassified from AOCI into Income	Amount of Gain or (Loss) Reclassified from AOCI into Income

	(Effective Portion)		(Effective Portion)	(Effective Portion)	
Derivatives designated as hedging instruments under ASC 815:					
Interest rate swap contracts	$	(214)	interest income/(expense)	$	
Total derivatives	$	(214)		$	

	For the nine months ended September 30, 2009				
	Amount of Gain or (Loss) Recognized in Other Comprehensive Income on Derivatives (Effective Portion)		Location of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)	
Derivatives designated as hedging instruments under ASC 815:					
Interest rate swap contracts	$	(435)	interest income/(expense)	$	
Total derivatives	$	(435)		$	

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Amounts in accumulated other comprehensive income (loss) will be reclassified into earnings under certain situations; for example, if the occurrence of the transaction is no longer probable or no longer qualifies for hedge accounting. The Company expects to reclassify approximately $467,000 currently included in other accumulated other comprehensive income (loss) into interest expense within the next 12 months.

6. Long-Term Debt:

On February 6, 2009, the Company entered into a commercial loan agreement to finance computer software and equipment purchases in the amount of $2,036,114. The loan is collateralized by the related computer software and equipment. The loan is a three year loan with a fixed rate of 4.78% with monthly installments, including interest, of $60,823 beginning on March 31, 2009, and it matures on February 28, 2012.

7. Property and Equipment, net:

Property and equipment, at cost, consist of the following as of the dates indicated (amounts in thousands):

	September 30, 2009	December 31, 2008
Software	$ 15,648	$ 14,380
Computer equipment	8,665	7,951
Furniture and fixtures	5,531	5,150
Equipment	5,928	5,370
Leasehold improvements	3,205	3,449
Building and improvements	5,979	5,948
Land	992	992
Accumulated depreciation and amortization	(23,855)	(19,356)
Property and equipment, net	$ 22,093	$ 23,884

Depreciation and amortization expense, relating to property and equipment, for the three and nine months ended September 30, 2009 was $1,600,764 and $4,869,540, respectively. Depreciation and amortization expense, relating to property and equipment, for the three and nine months ended September 30, 2008 was $1,462,637 and $3,715,492, respectively.

Beginning in July 2006 upon initiation of certain internally developed software projects, in accordance with the guidance of FASB ASC Topic 350-40 Internal-Use Software (ASC 350-40), the Company began capitalizing qualifying computer software costs incurred during the application development stage and amortizing them over their estimated useful life of three to seven years on a straight-line basis beginning when the project is completed. Costs associated with preliminary project stage activities, training, maintenance and all other post implementation stage activities are expensed as incurred. The Company s policy provides for the capitalization of certain direct payroll costs for employees who are directly associated with internal use computer software projects, as well as external direct costs of services associated with developing or obtaining internal use software. Capitalizable personnel costs are limited to the time directly spent on such projects. As of September 30, 2009, the Company has incurred and capitalized $2,273,069 of these direct payroll costs and external direct costs related to software developed for internal use. Of these costs, $1,570,493 is for projects that are in the development stage and, therefore are a component of Other Assets. Once the projects are completed, the costs will be transferred to Software and amortized over their estimated useful life of three to seven years. Amortization expense for the three and nine months ended September 30, 2009 was $25,229 and $69,501, respectively. Amortization expense for the three and nine months ended September 30, 2008 was $22,136 and $66,408, respectively. The remaining unamortized costs relating to internally developed software at September 30, 2009 and 2008 were $523,079 and $410,995, respectively.

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8. Goodwill and Intangible Assets, net:

With the acquisition of IGS on October 1, 2004, RDS on July 29, 2005, The Palmer Group on July 25, 2007, MuniServices on July 1, 2008, and Broussard Partners and Associates, Inc. (BPA) on August 1, 2008, the Company purchased certain tangible and intangible assets. Intangible assets purchased included client and customer relationships, non-compete agreements, trademarks and goodwill. In accordance FASB ASC Topic 350 Intangibles-Goodwill and Other (ASC 350), the Company is amortizing the following intangible assets over the estimated useful lives as indicated:

	Customer Relationships	Non-Compete Agreements	Trademarks
IGS	7 years	3 years	
RDS	10 years	3 years	
The Palmer Group	2.4 years		
MuniServices	11 years	3 years	14 years
BPA	10 years	2.4 years	

The combined original weighted average amortization period is 9.14 years. The Company reviews these relationships at least annually for impairment. Total amortization expense was $668,277 and $2,004,831 for the three and nine months ended September 30, 2009, respectively. Total amortization expense was $699,598 and $1,422,938 for the three and nine months ended September 30, 2008, respectively. In addition, goodwill, pursuant to ASC 350, is not amortized but rather is reviewed at least annually for impairment. During the fourth quarter of 2008, the Company underwent its annual review of goodwill. Based upon the results of this review, which was conducted as of October 1, 2008, no impairment charges to goodwill or the other intangible assets were necessary as of the date of this review. The Company believes that nothing has occurred since the review was performed through September 30, 2009 that would indicate a triggering event and thereby necessitate an impairment charge to goodwill or the other intangible assets. The Company will undergo its annual goodwill review during the fourth quarter of 2009. At September 30, 2009 and December 31, 2008, the carrying value of goodwill was $29,298,717 and $27,545,582, respectively. The $1,753,135 increase in the carrying value of goodwill during the nine months ended September 30, 2009 relates to additional purchase price relating to the acquisition of BPA on August 1, 2008 and MuniServices on July 1, 2008.

9. Share-Based Compensation:

The Company has a stock option and nonvested share plan. The Company created the 2002 Stock Option Plan (the Plan) on November 7, 2002. The Plan was amended in 2004 (the Amended Plan) to enable the Company to issue nonvested shares of stock to its employees and directors. The Amended Plan was approved by the Company s shareholders at its Annual Meeting on May 12, 2004. Up to 2,000,000 shares of common stock may be issued under the Amended Plan. The Amended Plan expires November 7, 2012.

Effective January 1, 2006, the Company adopted the provisions of FASB ASC Topic 718 Compensation-Stock Compensation (ASC 718), using the modified prospective approach. The adoption had no material impact on the Company s Consolidated Income Statement or on previously reported interim periods. As of September 30, 2009, total future compensation costs related to nonvested awards of nonvested shares (not including nonvested shares granted under the Long-Term Incentive Program) is estimated to be $2.8 million with a weighted average remaining life of 2.5 years (not including nonvested shares granted under the Long-Term Incentive Programs). As of September 30, 2009, there is no future compensation costs related to stock options and the remaining vested stock options have a weighted average remaining life of 0.9 years. Based upon historical data, the Company used an annual forfeiture rate of 14% for stock options and 15-40% for nonvested shares for most of the employee grants. Grants made to key employee hires and directors of the Company were assumed to have no forfeiture rates associated with them due to the historically low turnover among this group. In addition, commensurate with the adoption of the guidance, all previous references to restricted stock are now referred to as nonvested shares.

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Total share-based compensation expense was $588,595 and $3,240,301 for the three and nine months ended September 30, 2009, respectively. Total share-based compensation expense (benefit) was ($720,587) and $442,014 for the three and nine months ended September 30, 2008, respectively. The Company, in conjunction with the renewal of employment agreements with its Named Executive Officers and other senior executives, awarded nonvested shares which vested on January 1, 2009. As a result of the vesting of these shares, the Company recorded stock-based compensation expense in connection with these shares, in the amount of approximately $1.4 million during the first quarter of 2009. Tax benefits resulting from tax deductions in excess of share-based compensation expense recognized under the fair value recognition provisions of ASC 718 (windfall tax benefits) are credited to additional paid-in capital in the Company s Consolidated Balance Sheets. Realized tax shortfalls are first offset against the cumulative balance of windfall tax benefits, if any, and then charged directly to income tax expense. The total tax benefit realized from share-based compensation was $731,867 and $1,923,946 for the three and nine months ended September 30, 2009, respectively. The total tax benefit realized from share-based compensation was $404,965 and $857,782 for the three and nine months ended September 30, 2008, respectively.

Stock Options

All options issued under the Amended Plan vest ratably over five years. Granted options expire seven years from grant date. Expiration dates range between November 7, 2009 and January 16, 2011. Options granted to a single person cannot exceed 200,000 in a single year. At September 30, 2009, 895,000 options have been granted under the Amended Plan, of which 118,955 have been cancelled. There were 0 and 33,000 antidilutive options outstanding for the three and nine months ended September 30, 2009, respectively. There were no antidilutive options outstanding for the three and nine months ended September 30, 2008.

The Company granted no options during the three and nine months ended September 30, 2009 and 2008. All of the stock options which have been granted under the Amended Plan were granted to employees of the Company except for 40,000 which were granted to non-employee directors. The total intrinsic value of options exercised during the three and nine months ended September 30, 2009 was approximately $1,199,000 and $2,306,000, respectively. The total intrinsic value of options exercised during the three and nine months ended September 30, 2008 was approximately $345,000 and $895,000, respectively.

The following summarizes all option related transactions from December 31, 2007 through September 30, 2009 (amounts in thousands, except per share amounts):

	Options Outstanding	Weighted-Average Exercise Price	Weighted-Average Fair Value
December 31, 2007	163	$ 16.97	$ 3.25
Exercised	(38)	15.87	3.31
Cancelled	(2)	21.50	4.60
December 31, 2008	123	17.24	3.21
Exercised	(102)	15.92	3.29
September 30, 2009	21	$ 23.79	$ 2.78

The following information is as of September 30, 2009 (amounts in thousands, except per share amounts):

	Options Outstanding				Options Exercisable		
			Weighted-Average			Weighted-	
		Average	Exercise			Average	
Exercise	Number	Remaining	Price Per	Aggregate	Number	Exercise	Aggregate

Prices	Outstanding	Contractual Life	Share	Intrinsic Value	Exercisable	Price Per Share	Intrinsic Value
$13.00	7	0.1	$ 13.00	$ 216	7	$ 13.00	$ 216
$28.45 - $29.79	14	1.3	28.93	229	14	28.93	229
Total as of September 30, 2009	21	0.9	$ 23.79	$ 445	21	$ 23.79	$ 445

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The Company utilizes the Black-Scholes option pricing model to calculate the value of the stock options when granted. This model was developed to estimate the fair value of traded options, which have different characteristics than employee stock options. In addition, changes to the subjective input assumptions can result in materially different fair market value estimates. Therefore, the Black-Scholes model may not necessarily provide a reliable single measure of the fair value of employee stock options.

Nonvested Shares

With the exception of the awards made pursuant to the Long-Term Incentive Program and a few employee and director grants, the terms of the nonvested share awards are similar to those of the stock option awards, wherein the nonvested shares vest ratably over five years and are expensed over their vesting period. In addition, in conjunction with the renewal of their employment agreements, the Company s Named Executive Officers and other senior executives were awarded nonvested shares which vested on January 1, 2009. As a result of the vesting of these shares, the Company recorded stock-based compensation expense in connection with these shares, in the amount of approximately $1.4 million during the first quarter of 2009.

The following summarizes all nonvested share transactions from December 31, 2007 through September 30, 2009 (amounts in thousands, except per share amounts):

	Nonvested Shares Outstanding	Weighted-Average Price at Grant Date
December 31, 2007	123	$ 41.72
Granted	27	37.47
Vested	(37)	39.55
Cancelled	(15)	40.05
December 31, 2008	98	41.60
Granted	69	33.93
Vested	(73)	36.85
Cancelled	(5)	41.91
September 30, 2009	89	$ 39.57

The total grant date fair value of shares vested during the three and nine months ended September 30, 2009 was $593,806 and $2,687,986, respectively. The total grant date fair value of shares vested during the three and nine months ended September 30, 2008 was $598,382 and $1,278,168, respectively.

Long-Term Incentive Programs

Pursuant to the Amended Plan, on March 30, 2007, January 4, 2008 and January 20, 2009, the Compensation Committee approved the grant of 96,550, 80,000 and 108,720 performance-based nonvested shares, respectively. The shares were granted to key employees of the Company. For both the 2007 and 2008 grants, no estimated compensation costs have been accrued because the achievements of the performance targets of the programs were deemed unlikely to be achieved. In the future, if the Company believes that the performance targets of the programs will be achieved, an adjustment to the expense will be made at that time based on the probable outcome. The 2009 grant is performance based and cliff vests after the requisite service period of two to three years if certain financial goals are met. The goals are based upon diluted earnings per share (EPS) totals for 2009, the return on owners equity for the three year period beginning on January 1, 2009 and ending December 31, 2011, and the relative total shareholder return as compared to a peer group, for the same three year period. The number of shares vested can double if the financial goals are exceeded or no shares can vest if the financial goals are not met. The Company is expensing the nonvested share grant over the requisite service period of two to three years beginning on January 1, 2009. If the Company believes that the number of shares granted will be more or less than originally projected, an adjustment to the expense will be made at that time based on the probable outcome. At September 30, 2009, no

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compensation expense relating to the EPS goal has been accrued as the achievement of the EPS goal is not likely to be achieved. At September 30, 2009, total future compensation costs related to nonvested share awards granted under the 2009 Long-Term Incentive Program are estimated to be approximately $1.4 million. The Company assumed a 7.5% forfeiture rate for this grant and the remaining shares have a weighted average life of 2.25 years at September 30, 2009.

10. Income Taxes:

On July 13, 2006, the FASB issued accounting guidance on accounting for uncertainty in income taxes. This guidance clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB ASC Topic 740 Income Taxes (ASC 740). The guidance prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The evaluation of a tax position in accordance with the guidance is a two-step process. The first step is recognition: the enterprise determines whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, the enterprise should presume that the position will be examined by the appropriate taxing authority that would have full knowledge of all relevant information. The second step is measurement: a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

The Company adopted the guidance with respect to all of its tax positions as of January 1, 2007. Total unrecognized tax benefits at September 30, 2009 and 2008 were $0 and $180,000, respectively. On September 15, 2008, the 2004 tax year closed and is no longer subject to examination by major taxing jurisdictions, including the Internal Revenue Service. As a result, the remaining unrecognized tax benefits balance of $180,000 was reversed. The reversal was an adjustment to additional paid-in-capital and did not affect the annual effective tax rate.

The Company was notified on June 21, 2007 that it was being examined by the Internal Revenue Service for the 2005 calendar year. The IRS has concluded its audit and on March 19, 2009 issued Form 4549-A, Income Tax Examination Changes for tax years ending December 31, 2007, 2006 and 2005. The IRS has proposed that cost recovery for tax revenue recognition does not clearly reflect income and that unused line fees paid on credit facilities should be capitalized and amortized rather than taken as a current deduction. On April 22, 2009, the Company filed a formal protest of the findings contained in the examination report prepared by the IRS. The Company believes it has sufficient support for the technical merits of its positions and that it is more-likely-than-not these positions will ultimately be sustained; therefore, a reserve for uncertain tax positions is not necessary. If the Company is unsuccessful in its appeal, it might be required to pay the related deferred taxes and any potential interest in the near-term, possibly requiring additional financing from other sources.

At September 30, 2009, the tax years that remain subject to examination by the major taxing jurisdictions, including the Internal Revenue Service, are 2003 and 2005 and subsequent years. The 2003 tax year is still open to examination because of the net operating loss that originated in that year but was not fully utilized until the 2005 tax year.

ASC 740 requires the recognition of interest, if the tax law would require interest to be paid on the underpayment of taxes, and recognition of penalties, if a tax position does not meet the minimum statutory threshold to avoid payment of penalties. Penalties and interest may be classified as either penalties and interest expense or

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income tax expense. Management has elected to classify accrued penalties and interest as income tax expense. Accrued penalties and interest as of January 1, 2007, in the amount of $77,000, were recorded to beginning of year retained earnings at the date of adoption. Since January 1, 2007, the Company has accrued additional interest of approximately $34,000. Due to the approved application for change in accounting method, the balance of accrued penalties and interest was reduced by $67,000 during 2007. As a result of the lapse in the statute of limitations, the 2004 tax year closed as of September 15, 2008 resulting in the reversal of the remaining $44,000 of accrued interest. No interest or penalties were accrued or reversed in 2009.

11. Earnings per Share:

Basic EPS are computed by dividing income available to common shareholders by weighted average common shares outstanding. Diluted EPS are computed using the same components as basic EPS with the denominator adjusted for the dilutive effect of stock options and nonvested share awards. Share-based awards that are contingent upon the attainment of performance goals are not included in the computation of diluted EPS until the performance goals have been attained. The following tables provide a reconciliation between the computation of basic EPS and diluted EPS for the three and nine months ended September 30, 2009 and 2008 (amounts in thousands, except per share amounts):

	For the three months ended September 30,					
	2009			2008		
	Net Income	Weighted Average Common Shares	EPS	Net Income	Weighted Average Common Shares	EPS
Basic EPS	$10,096	15,466	$0.65	$11,455	15,267	$0.75
Dilutive effect of stock options and nonvested share awards		36			69	
Diluted EPS	$10,096	15,502	$0.65	$11,455	15,336	$0.75

	For the nine months ended September 30,					
	2009			2008		
	Net Income	Weighted Average Common Shares	EPS	Net Income	Weighted Average Common Shares	EPS
Basic EPS	$31,892	15,392	$2.07	$34,751	15,210	$2.28
Dilutive effect of stock options and nonvested share awards		36			70	
Diluted EPS	$31,892	15,428	$2.07	$34,751	15,280	$2.27

There were 0 and 33,000 antidilutive options outstanding for the three and nine months ended September 30, 2009. There were no antidilutive options outstanding for the three and nine months ended September 30, 2008.

12. Commitments and Contingencies:

Employment Agreements:

The Company has employment agreements with all of its executive officers and with several members of its senior management group, most of which expire on December 31, 2011. Such agreements provide for base salary payments as well as bonuses which are based on the attainment of specific management goals. Future compensation under these agreements is approximately $8.5 million. The agreements also contain confidentiality and non-compete provisions.

Leases:

The Company is party to various operating and capital leases with respect to its facilities and equipment. For further discussion of these leases please refer to the Company s audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K, as filed for the year ended December 31, 2008.

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Forward Flow Agreements:

The Company is party to several forward flow agreements that allow for the purchase of defaulted consumer receivables at pre-established prices. The maximum remaining amount to be purchased under forward flow agreements at September 30, 2009 is approximately $73.9 million.

Litigation:

The Company is from time to time subject to routine legal claims and proceedings, most of which are incidental to the ordinary course of its business. The Company initiates lawsuits against consumers and is occasionally countersued by them in such actions. Also, consumers, either individually, as a member of a class action, or through a governmental entity on behalf of consumers, may initiate litigation against the Company, in which they allege that the Company has violated a state or federal law in the process of collecting on an account. From time to time, other types of lawsuits are brought against the Company. While it is not expected that these or any other legal proceedings or claims in which the Company is involved will, either individually or in the aggregate, have a material adverse impact on the Company s results of operations, liquidity or its financial condition, the matter described below falls outside of the normal parameters of the Company s routine legal proceedings.

PRA is currently a defendant in a purported class action counterclaim entitled PRA v. Barkwell, 4:09-cv-00113-CDL, which was originally filed in the Superior Court of Muscogee County, Georgia. The counterclaim, which was filed against PRA, the National Arbitration Forum (NAF) and MBNA American Bank, N.A., on July 29, 2009, has since been removed to the United States District Court for the Middle District of Georgia, where it is currently pending. The counterclaim alleges that in pursuing arbitration claims against Barkwell and other consumer debtors, pursuant to the terms and conditions of their respective cardholder agreements, PRA breached a duty of good faith and fair dealing and made negligent misrepresentations concerning its arbitration practices. The plaintiffs are seeking, among other things, to vacate the arbitration awards that PRA has obtained before NAF and have PRA disgorge the amounts collected with respect to such awards. It is not possible at this time to accurately estimate the possible loss, if any. PRA believes it has meritorious defenses to the allegations made in this counterclaim and intends to defend itself vigorously against them.

13. Estimated Fair Value of Financial Instruments:

The accompanying consolidated financial statements include various estimated fair value information as of September 30, 2009, as required by FASB ASC Topic 825 Financial Instruments (ASC 825). ASC 825 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 825 also requires the consideration of differing levels of inputs in the determination of fair values. Based upon the fact there are no quoted prices in active markets or other observable market data, the Company used unobservable inputs for computation of the fair value of finance receivables, net. Disclosure of the estimated fair values of financial instruments often requires the use of estimates. The Company uses the following methods and assumptions to estimate the fair value of financial instruments.

Cash and cash equivalents: The carrying amount approximates fair value.

Finance receivables, net: The Company records purchased receivables at cost, which represents a significant discount from the contractual receivable balances due. The cost of the receivables is reduced as cash is received based upon the guidance of ASC 310-30. The carrying amount of finance receivables, net, as of September 30, 2009 was approximately $661 million. The Company computed the fair value of these receivables using proprietary pricing models that the Company utilizes to make portfolio purchase decisions. As of September 30, 2009, using the aforementioned methodology, the Company computed the approximate fair value to be $767 million.

Long-term debt: The carrying amount approximates fair value, as the interest rates approximate the rate currently offered to the Company for similar debt instruments of comparable maturities by the Company s bankers.

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Line of credit: The carrying amount approximates fair value, as the interest rates approximate the rate currently offered to the Company for similar debt instruments of comparable maturities by the Company s bankers.

Derivative instrument: The interest rate swap is recorded at fair value, which is determined using pricing models developed based on the LIBOR swap rate and other observable market data, adjusted for nonperformance risk of both the counterparty and the Company.

14. Recent Accounting Pronouncements:

In December 2007, the FASB issued guidance which clarifies the accounting for business combinations in accordance with FASB ASC Topic 805 Business Combinations (ASC 805). The guidance establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. It also provides guidance for recognizing and measuring the goodwill acquired in the business combination, recognizing assets acquired and liabilities assumed arising from contingencies, and determining what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. The guidance is effective for acquisitions consummated in fiscal years beginning after December 15, 2008. The Company adopted the guidance on January 1, 2009, which had no material impact on its consolidated financial statements.

In December 2007, the FASB issued guidance on noncontrolling interests in consolidated financial statements. This guidance requires that the noncontrolling interest in the equity of a subsidiary be accounted for and reported as equity, provides revised guidance on the treatment of net income and losses attributable to the noncontrolling interest and changes in ownership interests in a subsidiary and requires additional disclosures that identify and distinguish between the interests of the controlling and noncontrolling owners. The guidance is effective for fiscal years beginning after December 15, 2008 with early application prohibited. The Company adopted the guidance on January 1, 2009, which had no material impact on its consolidated financial statements.

In March 2008, the FASB issued disclosure requirements regarding derivative instruments and hedging activities. Entities must now provide enhanced disclosures on an interim and annual basis regarding how and why the entity uses derivatives; how derivatives and related hedged items are accounted for, and how derivatives and related hedged items affect the entity s financial position, financial results and cash flow. The guidance is effective for periods beginning on or after November 15, 2008. The Company adopted the guidance effective January 1, 2009 and has added the required narrative and tabular disclosure in Note 5 of its consolidated financial statements.

In April 2008, the FASB issued guidance regarding the determination of the useful life of intangible assets. In developing assumptions about renewal or extension options used to determine the useful life of an intangible asset, an entity needs to consider its own historical experience adjusted for entity-specific factors. In the absence of that experience, an entity shall consider the assumptions that market participants would use about renewal or extension options. The guidance is effective for fiscal years beginning after December 15, 2008. The Company adopted the guidance on January 1, 2009, which had no material impact on its consolidated financial statements.

In April 2009, the FASB issued guidance on determining fair value when the volume and level of activity for an asset or liability has significantly decreased, and in identifying transactions that are not orderly. Based on the guidance, if an entity determines that the level of activity for an asset or liability has significantly decreased and that a transaction is not orderly, further analysis of transactions or quoted prices is needed, and a significant adjustment to the transaction or quoted prices may be necessary to estimate fair value. The guidance was effective on a prospective basis for interim and annual periods ending after June 15, 2009. The Company adopted the guidance during the second quarter of 2009, which had no material impact on its consolidated financial statements.

In April 2009, the FASB issued additional requirements regarding interim disclosures about the fair value of financial instruments which were previously only disclosed on an annual basis. Entities are now required to disclose the fair value of financial instruments which are not recorded at fair value in the financial statements in both their

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interim and annual financial statements. The standard is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company adopted these requirements during the second quarter of 2009, and has added the required disclosure in Note 13 of its consolidated financial statements.

In April 2009, the FASB issued guidance on the recognition and presentation of other-than-temporary impairments on investments in debt securities. If an entity s management asserts that it does not have the intent to sell a debt security and it is more likely than not that it will not have to sell the security before recovery of its cost basis, then an entity may separate other-than-temporary impairments into two components: 1) the amount related to credit losses (recorded in earnings), and 2) all other amounts (recorded in other comprehensive income). The guidance is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, and will be applied to all existing and new investments in debt securities. The Company adopted the guidance during the second quarter of 2009, which had no material impact on its consolidated financial statements.

In May 2009, the FASB issued guidance on subsequent events which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. This guidance, which falls under ASC Topic 855 Subsequent Events , provides guidance on the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The Company adopted the guidance during the second quarter of 2009, and its application had no impact on the Company s consolidated financial statements. The Company evaluated subsequent events through the date the accompanying financial statements were issued, which was November 6, 2009.

In June 2009, the FASB issued guidance on accounting for transfers of financial to improve the reporting for the transfer of financial assets. The guidance must be applied as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company believes the guidance will have no material impact on its consolidated financial statements.

In June 2009, the FASB issued guidance on consolidation of variable interest entities to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. The guidance is effective as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company believes the guidance will have no material impact on its consolidated financial statements.

In June 2009, the FASB issued The FASB Accounting Standards Codification (Codification). The Codification became the single source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The Codification supersedes all existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification is non-authoritative. The Codification was effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company adopted the Codification for the quarter ending September 30, 2009. There was no impact to its consolidated financial statements as this change is disclosure-only in nature.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Cautionary Statements Pursuant to Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995:

This report contains forward-looking statements within the meaning of the federal securities laws. These forward-looking statements involve risks, uncertainties and assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. All statements, other than statements of historical fact, are forward-looking statements, including statements regarding overall trends, gross margin trends, operating cost trends, liquidity and capital needs and other statements of expectations, beliefs, future plans and strategies, anticipated events or trends, and similar expressions concerning matters that are not historical facts. The risks, uncertainties and assumptions referred to above may include the following:

continued deterioration of the economic environment including the stability of the financial system;

our ability to purchase defaulted consumer receivables at appropriate prices;

changes in the business practices of credit originators in terms of selling defaulted consumer receivables or outsourcing defaulted consumer receivables to third-party contingent fee collection agencies;

changes in government regulations that affect our ability to collect sufficient amounts on our acquired or serviced receivables;

changes in income tax laws or challenges by taxing authorities could have an adverse effect on our financial condition and results of operations;

deterioration in economic conditions in the United States that may have an adverse effect on our collections, results of operations, revenue and stock price;

changes in bankruptcy or collection agency laws that could negatively affect our business;

our ability to employ and retain qualified employees, especially collection and information technology personnel;

our work force could become unionized in the future, which could adversely affect the stability of our production and increase our costs;

changes in the credit or capital markets, which affect our ability to borrow money or raise capital to purchase or service defaulted consumer receivables;

the degree and nature of our competition;

our ability to comply with the provisions of the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated thereunder;

our ability to retain existing clients and obtain new clients for our fee-for-service businesses;

the sufficiency of our funds generated from operations, existing cash and available borrowings to finance our current operations; and the risk factors listed from time to time in our filings with the Securities and Exchange Commission (the SEC).

You should assume that the information appearing in this quarterly report is accurate only as of the date it was issued. Our business, financial condition, results of operations and prospects may have changed since that date.

For a discussion of the risks, uncertainties and assumptions that could affect our future events, developments or results, you should carefully review the following Management s Discussion and Analysis of Financial Condition and Results of Operations , as well as the discussion of Business and Risk Factors described in our 2008 Annual Report on Form 10-K, filed on February 27, 2009.

Our forward-looking statements could be wrong in light of these and other risks, uncertainties and assumptions. The future events, developments or results described in this report could turn out to be materially different. We have no obligation to publicly update or revise our forward-looking statements after the date of this report and you should not expect us to do so.

Investors should also be aware that while we do, from time to time, communicate with securities analysts and others, we do not, by policy, selectively disclose to them any material nonpublic information or other confidential commercial information. Accordingly, stockholders should not assume that we agree with any statement or report issued by any analyst regardless of the content of the statement or report. We do not, by policy, confirm forecasts or projections issued by others. Thus, to the extent that reports issued by securities analysts contain any projections, forecasts or opinions, such reports are not our responsibility.

Results of Operations

We are a full service provider of outsourced receivables management and related services. The results of operations include the financial results of Portfolio Recovery Associates, Inc. and all of our subsidiaries who are all in the accounts receivable management business. Under the guidance of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 280 Segment Reporting (ASC 280), we have determined that we have several operating segments that meet the aggregation criteria of ASC 280, and therefore, we have one reportable segment, accounts receivable management, based on similarities among the operating units including homogeneity of services, service delivery methods and use of technology.

The following table sets forth certain operating data as a percentage of total revenues for the periods indicated:

	For the Three Months Ended September 30,		**For the Nine Months Ended September 30,**	
	2009	**2008**	**2009**	**2008**
Revenues:				
Income recognized on finance receivables, net	79.2%	76.9%	76.8%	80.7%
Commissions	20.8%	23.1%	23.2%	19.3%
Total revenues	100.0%	100.0%	100.0%	100.0%
Operating expenses:				
Compensation and employee services	39.2%	33.5%	38.5%	33.1%
Legal and agency fees and costs	16.5%	21.0%	16.6%	20.2%
Outside fees and services	3.3%	3.4%	3.3%	3.5%
Communications	5.1%	3.3%	5.4%	3.8%
Rent and occupancy	1.9%	1.6%	1.7%	1.4%
Other operating expenses				